

Message Text

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ORIGIN TRSE-00

INFO OCT-01 EA-06 NEA-06 ISO-00 EB-07 SP-02 AID-05 NSC-05

RSC-01 CIEP-01 SS-15 STR-01 OMB-01 CEA-01 CIAE-00

COME-00 FRB-01 INR-05 NSAE-00 XMB-02 OPIC-03 LAB-01

SIL-01 SSO-00 NSCE-00 INRE-00 USIE-00 PA-01 PRS-01

L-02 H-01 /070 R

DRAFTED BY TREAS:PGONZALEZ/JBUSHNELL:WW

APPROVED BY EB/IFD/ODF:REBENEDICK

NEA:SSOBER (SUBS)

EA:LEDMONDS (SUBS)

TREAS:CCOOPER

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FM SECSTATE WASHDC

TO AMEMBASSY MANILA IMMEDIATE

AMEMBASSY COLOMBO PRIORITY

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E.O. 11652: N/A

TAGS: EAID, EFIN, CE

SUBJECT: U.S. POSITION ON COST OVERRUNS AND PROPOSED ADB
SUPPLEMENTARY LOANS TO SRI LANKA

FOR USADB

1. YOU ARE INSTRUCTED TO TAKE THE OPPORTUNITY OF THE
DISCUSSION AND VOTE ON THE TWO SRI LANKA LOANS TO FOCUS THE
BOARD'S AND MANAGEMENT'S ATTENTION ON THE GENERAL PROBLEM
OF COST OVERRUNS, AND TO STATE U.S. POLICY ON THIS SUBJECT.

2. YOU SHOULD INCLUDE THE FOLLOWING POINTS IN YOUR GENERAL
PRESENTATION.

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(A) A LARGE NUMBER OF COST INCREASE SUPPLEMENTAL LOANS

WILL REFLECT POORLY ON THE ADB'S TECHNICAL REVIEW AND BANKING PROCEDURES, IN COMPARISON WITH OTHER IFIS.

(B) OVERRUNS ABSORB SCARCE BANK RESOURCES OF MANPOWER AND FUNDS WHICH ARE NEEDED FOR NEW PROJECTS.

(C) FAILURE TO IMPOSE THE DISCIPLINE OF REQUIRING BORROWERS TO FINANCE COST OVERRUNS ENCOURAGES DELAYS IN PROJECT IMPLEMENTATION. BORROWERS SHOULD REALIZE THAT IN THESE INFLATIONARY TIMES DELAYS IN PROJECT IMPLEMENTATION WILL RESULT IN HIGHER COSTS WHICH THEY WILL HAVE TO FUND.

(D) A FLEXIBLE POLICY ON COST OVERRUNS TENDS TO ENCOURAGE INITIAL UNDERESTIMATION OF PROJECT COSTS AS A TECHNIQUE FOR INCREASING THE BANK'S FINANCING OF THE PROJECT THROUGH SUBSEQUENT COST OVERRUN LOANS.

(E) THE BORROWER'S COMMITMENT TO ASSUME RESPONSIBILITY FOR POSSIBLE COST INCREASES SHOULD BE A SERIOUS UNDERTAKING, BUT IT WILL BE TAKEN LIGHTLY IF THE BANK PROVIDES A SERIES OF SUPPLEMENTAL LOANS. MOREOVER THE ADB WILL IN EFFECT PENALIZE THOSE COUNTRIES AND INSTITUTIONS WHICH TAKE THIS COMMITMENT SERIOUSLY WHILE REWARDING THOSE THAT DO NOT. IF ADB PROJECTS ARE IN FACT AMONG THE HIGHEST PRIORITIES OF THE BORROWING COUNTRY, AS THEY SHOULD BE, WE BELIEVE THIS PRIORITY WOULD NORMALLY ASSURE FINANCING FROM LOCAL SOURCES FOR COST OVERRUNS.

(F) WE BELIEVE THE BANK SHOULD REVIEW ITS PROCEDURES CAREFULLY TO ASSURE THAT ADB PROCEDURES FOR ARRIVING AT COST ESTIMATES DO NOT CONTRIBUTE TO COST OVERRUN SITUATIONS. YOU SHOULD CALL FOR URGENT PREPARATION OF A PAPER FOR BOARD CONSIDERATION ON WAYS TO IMPROVE ENGINEERING ESTIMATES, INCLUDING A COMPARISON WITH PROCEDURES IN OTHER IFIS;

(G) WE STRONGLY BELIEVE A LOAN SHOULD NOT BE APPROVED UNTIL ADEQUATE COST ESTIMATES HAVE BEEN MADE (YOU MAY WANT TO RELATE THIS TO THE END OF YEAR RUSH AND URGE THAT THE LIMITED OFFICIAL USE

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BANK DELAY UPCOMING LOANS WHERE THE COST BASIS IS WEAK IN ORDER TO AVOID FUTURE PROBLEMS);

3. IN CONCLUDING YOUR STATEMENT YOU SHOULD SAY THAT THE U.S. OFFERS THESE COMMENTS IN A SPIRIT OF SUPPORT AND ENCOURAGEMENT TO BANK MANAGEMENT IN THEIR CONTINUING EFFORTS TO INCREASE THE ADB'S EFFECTIVENESS AND INTERNATIONAL STANDING. DOMESTIC LEGISLATIVE CONCERNS IN

THE U.S., WHICH ARE FAMILIAR TO MANAGEMENT AND OTHER MEMBERS, DICTATE THAT THE U.S. INCREASINGLY FOLLOW POLICIES WITH RESPECT TO IFI PROJECTS WHICH ARE AIMED AT MAXIMIZING IFI EFFECTIVENESS, EVEN IF THIS MEANS OPPOSING INDIVIDUAL ANS. IN THIS SPIRIT, THE U.S. DOES NOT FEEL THAT IT'S

IN THE FUTURE SUPPORT COST OVERRUN FUNDING UNLESS IT IS JUSTIFIED BY HIGHLY UNUSUAL CIRCUMSTANCES. WE SUGGEST THAT OTHER DIRECTORS MIGHT CONSIDER FOLLOWING A SIMILAR POLICY IN THE INTERESTS OF THE INSTITUTION'S LONG RANGE VIABILITY AND EFFECTIVENESS.

4. AFTER MAKING THE ABOVE STATEMENT TO THE BOARD, YOU ARE AUTHORIZED TO ABSTAIN ON THE SUPPLEMENTARY LOANS TO SRI LANKA FOR THE COMMUNICATIONS SATELLITE EARTH STATION AND THE MINERAL SANDS PROJECT. YOU SHOULD EXPLAIN THAT THE U.S. POSITION ON THESE LOANS IS RELATED TO THE COST OVERRUN ISSUE AND IS NOT INTENDED TO SINGLE OUT SRI LANKA, THAT WE ARE SYMPATHETIC TO THE CONTINUING DEVELOPMENT NEEDS OF THAT COUNTRY, AND THAT WE FULLY SUPPORT ADB LENDING TO SRI LANKA FOR SOUNDLY PREPARED PROJECTS.

5. FOR COLOMBO: DRAW ON ABOVE AS APPROPRIATE WITH HOST GOVERNMENT OFFICIALS IN EXPLAINING U.S. ABSTENTION IN ADB BOARD. INGERSOLL

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